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ORGANIZATION PRACTICE

Understanding your 'globalization penalty'

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Strong multinationals seem less healthy than successful companies that stick closer to home. How can that be?

The rapid growth of emerging markets is providing fresh impetus for companies to become ever more global in scope. Deep experience in other international markets means that many companies know globalization's potential benefits—which include accessing new markets and talent pools and capturing economies of scale—as well as a number of risks: creeping complexity, culture clashes, and vigorous responses from local competitors, to name just a few.

Less obvious is a challenge identified by our latest research: global reach seems to threaten the underlying health of far-flung organizations, even highly successful ones. In particular, we have found that high-performing global companies consistently score lower than more locally focused ones on several critical dimensions of organizational health—direction setting, coordination and control, innovation, and external orientation—that we have been studying at hundreds of companies over the past decade. Understanding this threat, and its causes, is a first step toward diminishing its impact.

Weaknesses

The data to support this finding come from McKinsey's organizational-health index database, which contains the results of surveys of more than 600,000 employees who assessed the health of nearly 500 different corporations. Within this database, we identified 20 "local champions," which had outperformed their industries over the previous ten years, and 18 "global champions," which had likewise outperformed their industries and met our composite criteria for full globalization.[1]

We then compared these companies across the elements of organizational health, which we define as the ability to align around a strategy or change program, to execute, and to renew a company faster than its competitors can.[2] Highlights of this analysis included the following:

- High-performing global organizations are consistently less effective at setting a shared vision and engaging employees around it than are their local counterparts.
- These global leaders also find maintaining professional standards and encouraging innovation of all kinds more difficult.
- Because they do business in multiple countries, they find it more challenging than local leaders do to build government and community relationships and business partnerships.

These findings are troubling. For starters, the weaknesses touch on all three major areas of organizational health—alignment, execution, and renewal. Since related research from our colleagues Scott Keller and Colin Price indicates that at least 50 percent of an organization's long-term success is a function of its health, this globalization penalty should be a red flag for high performers with a rapidly expanding international reach. What's more, the global leaders we studied represented the cream of the crop—they not only enjoyed strong financial performance but also had significant global scale and scope, which is why we included them in the sample. If organizations like these can't stay healthy as they grow globally, can any company?

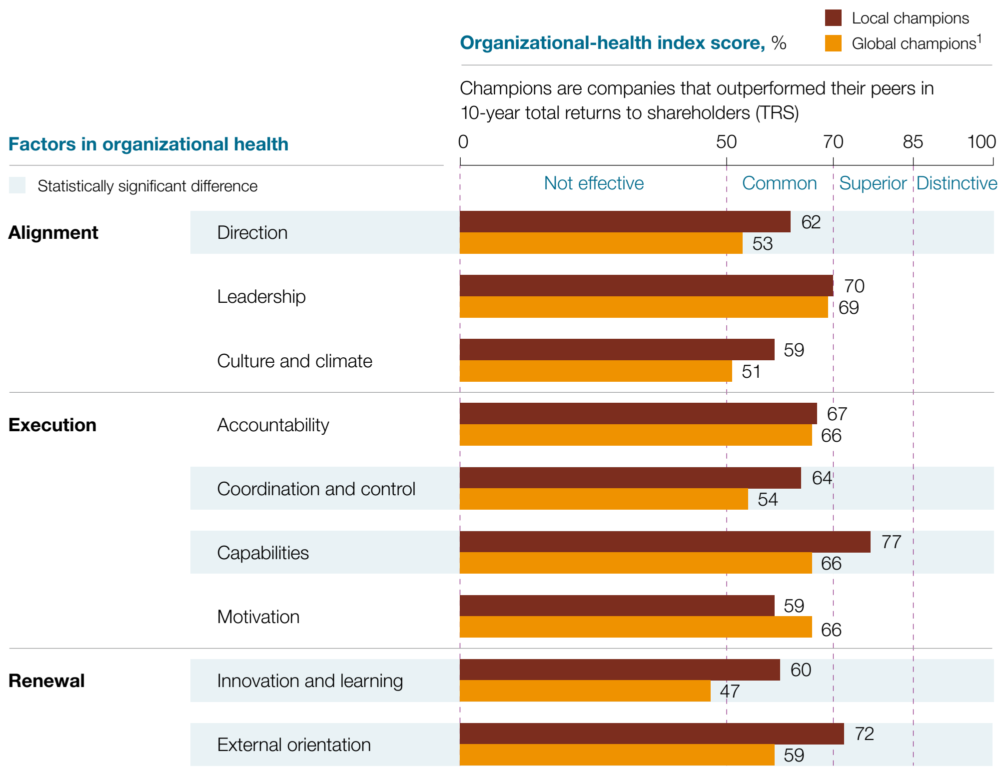
Pain points

To understand what lies beneath these findings, we interviewed executives at 50 global companies. Those interviews, while hardly dispositive, suggested a relationship between organizational health and a familiar challenge: balancing local adaption against global scale, scope, and coordination.

Almost everyone we interviewed seemed to struggle with this tension, which often plays out in heated internal debates. Which organizational elements should be standardized? To what extent does managing high-potential emerging markets on a country-by-country basis make sense? When is it better, in those markets, to leverage scale and synergies across business units in managing governments, regulators, partners, and talent? One global company, hoping to realize the benefits of scale and, simultaneously, of focusing intently on India and China, recently started deploying business unit "CEOs," whose responsibilities cut across both of those high-growth markets.

Complicating matters further, our interviews suggested that, for most companies, about 30 to 40 percent of existing internal networks and linkages are ineffective for managing global–local trade-offs and instead just add costs and complexity. Many companies, for example, can't identify transferable lessons about low-income consumers in one high-growth emerging market and apply them in another. Some struggle to coalesce rapidly around market-

Do companies pay a penalty for being global?



[1] Companies were defined as global based on proportion of sales outside of home geography, proportion of employees outside of home region, geographic diversity of top management team, and proportion of shareholders that are outside of home region.

Source: Organizational-health index database; McKinsey analysis

specific responses when local entrants undermine traditional business models and disrupt previously successful strategies.

Finally, many executives we interviewed are clearly wrestling with the corporate center's role in their increasingly globalized institutions. The feasibility of centralizing three functions in particular—human resources, finance, and marketing (broadly defined to include brand and reputation management)—was a question a number of leaders raised. In fact, our interviews suggest that it may be time for some companies to reimagine what the corporate center does, even to the extent of considering whether a single center is suited to the task of effectively directing and coordinating global operations.

It's easy to see how organizations working through such fundamental structural and operating questions might also struggle with activities—like setting a clear direction, building alignment, and maintaining innovative energy—that contribute to organizational health. Since even leading multinationals appear to suffer this globalization penalty, the importance of addressing it will only grow larger in the years ahead. For more and more companies, the globalization imperative is intensifying, and that could present additional organizational and leadership challenges that are not yet fully understood.

[1] We compared the degree of globalization using four metrics: the proportion of sales originating outside a company's home geography, the proportion of employees working outside a company's home region, the geographic diversity of a company's top management team, and the proportion of shareholders residing outside a company's home region. Of these, we weighted the source of sales and the location of management most heavily.

[2] For more, see Scott Keller and Colin Price, "Organizational health: The ultimate competitive advantage," mckinseyquarterly.com, June 2011.

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